DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 06-0090
Sales Tax
For Tax Years 1999-2002

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ISSUE

I. Sales Tax—Imposition.

Authority: IC § 6-8.1-5-1; 45 IAC 2.2-4-13; 45 IAC 2.2-5-8; 45 IAC 15-9-2.

Taxpayer protests imposition of sales tax on various items.

II. Tax Administration—Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana manufacturing business. Taxpayer filed sales tax refund claims for the years 1999 through 2002. In the course of the sales tax refund investigation, the Indiana Department of Revenue ("Department") offset a portion of the claimed sales tax refunds, denied inclusion of one subsidiary due to untimely filing, and issued proposed sales tax assessments for the years 2001 and 2002. Taxpayer protests the offset of refund, the denial for untimely filing, and some of the items included as subject to sales tax. Further facts will be supplied as required.

I. Sales Tax—Imposition.

DISCUSSION

Taxpayer protests several items. These items overlap for both the refund claims and the assessments. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the assessment is made, as provided by IC § 6-8.1-5-1(c).

Taxpayer's first point of protest is found in its initial protest letter. Taxpayer protests the Department's issuance of assessments for 2001 and 2002. Taxpayer states that those years were beyond the statute of limitations for issuing assessments. Of relevance is 45 IAC 15-9-2(c), which explains in part:

> If a taxpayer claims a refund for a period which is closed to issuance of a proposed assessment as defined in IC 6-8.1-5-2, the department may still examine the period in order to determine that the reasons set forth by the taxpayer for the refund are valid. The department may adjust the period to the extent necessary to make the issues raised by the refund conform to the applicable law.
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> EXAMPLE
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> A taxpayer claims a refund arising from alleged exempt sales in interstate commerce under the gross income tax. The tax period, 19X1, is open to a refund claim under IC 6-8.1-9-1 but is closed to assessment under IC 6-8.1-5-2. The department may still examine the 19X1 tax period in order to determine whether the interstate sales are exempt and were properly reported.
>
> ….

Therefore, under 45 IAC 15-9-2(c), the Department may offset refund claims and issue assessments in order to bring issues raised by the refund claim into conformance with the applicable law. The applicable laws here are the sales and use tax laws.

Taxpayer's next point of protest is the Department's decision to not include one subsidiary in the refund claim due to untimely filing of the refund claim. The Department's explanation was that the paperwork for the refund claim included figures for the subsidiary under the name of the parent corporation. A review of the documentation in the file shows no other instance of a requirement by the Department for separate reporting by the subsidiary.

While still believing that the claim as originally filed was correct, Taxpayer filed a new refund claim in the name of the subsidiary. There was also some confusion when the Department could not find a copy of the new refund claim and asked Taxpayer to send in a copy. The date the copy was received was deemed the date the claim was submitted, and that date was beyond the statute of limitations. A review of the documentation in the protest file shows that Taxpayer submitted a new refund claim in the name of the subsidiary within the statute of limitations. Ultimately, though, separate filing of the refund claim was not necessary since the Department had not required such reporting before. Therefore, the subsidiary's figures will be included in the refund claim as originally filed.

Taxpayer's next point of protest is that it is entitled additional refunds and exemptions from assessment based on the predominant use exemption for utilities. The exemption is found at 45 IAC 2.2-4-13, which states:

> (a) In general, the furnishing of electricity, gas, water, steam, or steam heating services by public utilities to consumers is subject to tax.
> (b) The gross receipt of every person engaged as a power subsidiary or a public utility derived from selling electrical energy, gas, water, or steam to consumers

> for direct use in direct manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, horticulture, or another public utility or power subsidiary described in IC 6-2.5-4-5 shall not constitute gross retail income of a retail merchant received from a retail transaction. Electrical energy, gas, water, or steam will only be considered directly used in direct production, manufacturing, mining, refining, oil or mineral extraction, irrigation, agriculture, or horticulture if the utilities would be exempt under IC 6-2.5-5-5.1.
> (c) Sales of public utility services or commodities to consumers engaged in manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, horticulture, or another public utility or power subsidiary described in IC 6-2.5-4-5, based on a single meter charge, flat rate charge, or other charge, are excepted if such services are separately metered or billed and will be used predominantly for the excepted purposes.
> (d) Sales of public utility services and commodities to consumers engaged in manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, or horticulture, based on a single meter charge, flat rate charge, or other charge, which will be used for both excepted and nonexcepted purposes are taxable unless such services and commodities are used predominantly for excepted purposes.
> (e) *Where public utility services are sold from a single meter and the services or commodities are utilized for both exempt and nonexempt uses, the entire gross receipts will be subject to tax unless the services or commodities are used predominantly for excepted purposes. Predominant use shall mean that more than fifty percent (50[percent]) of the utility services and commodities are consumed for excepted uses.*
> *(Emphasis added.)*

Taxpayer believes that it is entitled to the predominant use exemption, since the utilities are used predominantly to power air make-up units and heaters which are all required to make its fiberglass manufacturing possible. The Department granted the predominant use exemption to most of the electrical usage on the refund claims and also allowed small exemptions for gas usage. Taxpayer states that all of the meters it included in the refund claims qualify for the predominant use exemption. In support of this claim, Taxpayer has provided documentation establishing the use of electricity and gas in the manufacturing process. This documentation is sufficient to establish that the exempt use is greater than 50 percent of the utilities consumed. Therefore, the electric and gas meters Taxpayer included in the refund claims are eligible for the predominant use exemption found at 45 IAC 2.2-4-13(e).

Taxpayer's next point of protest is what it considers a typographical error. On schedule 2 of the audit report, there is a credit listed at $2,958, but it was carried forward in the calculations as $958. Taxpayer believes that this is a book-keeping error and requests the additional $2,000 credit. This point of Taxpayer's protest is sustained, subject to verification in a supplemental audit.

Next, Taxpayer protests the Department's decision to impose use tax on 55 percent of the Tyvek outer garments worn by Taxpayer's employees and exempt the remaining 45 percent. In its

protest letter, Taxpayer states that it believes that the Tyvek garments used by 95 percent of its employees, including the 45 percent already exempted by the Department, are eligible for the exemption found at 45 IAC 2.2-5-8(c)(2)(F), which states:

> (c) The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.
>
> –EXAMPLES–
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> …
> (2) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative.
> …
> (F) Safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production.
> ….

The Department agreed that 45 percent of the Tyvek garments were used in accordance with 45 IAC 2.2-5-8(c)(2)(F), to prevent contamination of the product, and 55 percent were used in other activities. In the course of the protest process, Taxpayer provided documentation establishing that the Tyvek garments are required throughout the manufacturing building, due to the presence of fiberglass dust and cuttings throughout the manufacturing area. This use qualifies for the 45 IAC 2.2-5-8(c)(2)(F) exemption since it allows the workers to participate in the production process without the injury which would occur through exposure to the fiberglass contamination. Therefore, regarding its protest that 95 percent of the Tyvek garments are eligible for the exemption found at 45 IAC 2.2-5-8(c)(2)(F), Taxpayer has met its burden under § 6-8.1-5-1(c).

Next, Taxpayer protests the Department's decision to impose use tax on some of the gloves Taxpayer purchased. Taxpayer contends that all gloves it purchased should be exempt under 45 IAC 2.2-5-8(c)(2)(F), since its employees handle sharp or hot metal or wood in the production process. Taxpayer provided documentation in support of this claim. Unlike the Tyvek garments, which were used primarily in the production process, the gloves are used in both the production process and in pre- and post-production activities, such as cutting steel strap on pallets of raw materials, and loading raw materials into production machinery prior to the beginning of the production process. While it is clear that the gloves used in these circumstances are necessary to prevent injury, it is also clear that they are used to participate in activities which take place prior to the first step in the production process. Taxpayer has not provided sufficient explanation and documentation to establish that the Department imposed use tax on gloves used in the production process, and has not met its burden under IC § 6-8.1-5-1(c).

Next, Taxpayer protests the imposition of use tax on its purchase of welder wire feeders. Taxpayer states that the feeders are exempt under 45 IAC 2.2-5-8(c), since the feeders are directly used in the production process. Taxpayer provided documentation showing the use of the feeders. The feeders themselves are powered and controlled, and act on the wire, rather than simply holding the wire while it is pulled off by other machinery. The welders and feeders are linked to form an integrated piece of manufacturing equipment. Taxpayer has met its burden under IC § 6-8.1-5-1(c).

In conclusion, the Department is able to issue assessments which would otherwise be out of statute, if it is necessary to bring issues raised by the refund claim into conformance with the applicable law, as provided by 45 IAC 15-9-2(c). Taxpayer has met its burden under IC § 6-8.1-5-1(c), with respect to its claim for the predominant use exemption on utilities, 95 percent of Tyvek purchases, and the welder wire feeders. Taxpayer has not met its burden under IC § 6-8.1-5-1(c) with respect to its purchase of gloves. The subsidiary was properly included under the parent's name in the original refund claim. The findings discussed above will be applied to both the refund claim and the assessments. A supplemental audit will be necessary to verify the $2,000 typographical credit error and to recalculate the amount of refund and the amount of assessment.

FINDING

Taxpayer's protest is sustained in part and denied in part.

II. Tax Administration—Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the tax years in question. Taxpayer protests the imposition of penalty. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

> If a person:
> …
> (3) incurs, upon examination by the department, a deficiency that is due to negligence;
> …
> the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which states:

> Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and

> follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

45 IAC 15-11-2(c) provides in pertinent part:

> The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, Taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC 6-8.1-10-2.1(a). Taxpayer has affirmatively established that it acted in a reasonable manner and not in a negligent manner, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is sustained.

WL/LS/DK August 1, 2007.